IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

In re:	)	
	)	
JEFFERSON COUNTY, ALABAMA,	)	CASE NO. 11-05736-TBB9
	)	Chapter 9
	)	
Debtor.	)	

SUPPLEMENTAL BRIEF OF THE JEFFERSON COUNTY SEWER SYSTEM RECEIVER IN SUPPORT OF THE RECEIVER'S EMERGENCY MOTION FOR (A) A DETERMINATION THAT THE RECEIVER SHALL CONTINUE TO OPERATE AND ADMINISTER THE SEWER SYSTEM PURSUANT TO THE RECEIVER ORDER OR (B) FOR RELIEF FROM AUTOMATIC STAY OR OTHER APPROPRIATE RELIEF

John S. Young, Jr., LLC, (the "Receiver") in its capacity as court-appointed receiver of the Jefferson County Sewer System (the "System") and as a party-in-interest,[1] by and through its undersigned counsel, submits this Supplemental Brief in support of its Motion (the "Motion") filed November 10, 2011 [Docket No. 40].[2] In further support of the Motion, the Receiver states as follows:

I. Introduction

In its Motion, the Receiver argued (1) that the Court lacks authority to remove the Receiver because Bankruptcy Code Section 543, which governs turnover of property in the hands of receivers, is not made applicable to Chapter 9 by Section 901; (2) that Section 903 prevented the Court from removing the Receiver because the Receiver is an officer of the State Court, an arm of the State exercising control over its political subdivision (the Debtor); (3) that

[1] The Receiver is a party in interest as a result of its possession and control of property that may belong to the Debtor and its appointment by Court Order to administer property of the Debtor, pay claims against the Debtor and manage the financial interests related to the operation of the System. *See In re Ofty Corp.*, 44 B.R. 479 (Bankr. D. Del. 1984).

[2] All factual and legal arguments contained in the Motion are incorporated herein by reference, and all capitalized terms used herein but not otherwise defined shall have the meaning ascribed to them in the Motion.

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the automatic stay does not apply to the exercise of creditors' rights in and to the "special revenues" of the System; (4) that the Court cannot divest the Receiver of rate-making authority properly granted to it pre-petition; (5) that the Court should abstain from exercising authority over the Receiver pursuant to the Rooker-Feldman doctrine, the Johnson Act, and mandatory and permissive abstention under 28 U.S.C. § 1334; and (6) that, in the event the Court decided against the Receiver on the above, cause still existed for relief from the automatic stay under Section 362(d)(1).

The Receiver submits this Supplemental Brief in further support of its Motion in order to clarify the arguments presented in its Motion in light of the Debtor's anticipated response. Specifically, the Receiver's argument in this Supplemental Brief addresses three main points: (1) the applicability of the automatic stay; (2) the effect of the Receiver's continued operation of the System on the Debtor's ability to propose a Chapter 9 plan; and (3) the effect of the Debtor's arguments in the prior state and federal court cases concerning state constitutional and abstention issues. As fully explained below, the automatic stay does not apply to the Receiver, the Receiver's continued operation of the System (including its rate-making authority) does not interfere with the Debtor's ability to propose a Chapter 9 plan, and the Debtor is collaterally estopped from arguing either that the State Court erred in appointing a receiver with rate-making authority or that the Court should not abstain from actions to remove the Receiver.

Further, to the extent not duplicative of the arguments made herein and in the Motion, the Receiver incorporates by reference the arguments made by the Indenture Trustee in its Motion [Docket No. 55], Financial Guaranty Insurance Company in its Joinder and Response [Docket No. 144], Assured Guaranty Municipal Corp. in its Memorandum [Docket No. 146], Syncora Guarantee Inc. in its Response and Memorandum of Supplemental Points [Docket No. 147], and the Liquidity Banks in Exhibit A to their Expedited Motion for Leave to File Joinder [Docket No. 184] (collectively, the "Supporting Statements").

II. Law and Argument

A. The Automatic Stay of Section 362 Does Not Apply to the Receiver in this Case

1. The Omission of Sections 543, 1104-1107 and 324 Indicates that Congress Intended that in Chapter 9 Cases the Automatic Stay Would Not Apply to Receivers Appointed Prepetition

Because the Court cannot compel the Receiver to turn over the assets of and control of the System under Section 543, the Court should find that the Receiver's actions in accordance with the Receiver Order do not violate the automatic stay provisions of Sections 362 and 922. In the November 10 Letter, the Debtor argues that the automatic stay requires that the Receiver turn over control of the System to the Debtor. However, the stay provisions of Sections 362 and 922 do not vitiate the Receiver Order and the Receiver's duties thereunder. Rather, the Debtor's rights to the System, even in the bankruptcy case, are subject to the pre-petition restrictions placed on the Debtor in the Receiver Order. *Moody v. Amoco Oil. Co.*, 734 F.2d 1200, 1213 (7th Cir. 1984) (finding generally that "[w]hatever rights a debtor has in property at the commencement of the case continue in bankruptcy—no more, no less.").

a. <u>The Debtor's Rights in the System are fixed as of the Petition Date.</u>

In a Chapter 9 bankruptcy case, the Debtor's property rights are fixed as of the petition date. The statutory provisions in a Chapter 11 case that permit a debtor to obtain greater rights (such as possession and control) are not applicable in this Chapter 9 case. In a case under Chapter 11, the turnover provisions of Sections 542 and 543 allow a debtor to obtain possessory rights that it did not have as of the petition date, and but for those sections would not have post-petition. *See United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983) (holding that, but for the turnover provisions of Section 542, possessory rights are not included in a Chapter 11 debtor's estate where the debtor lost possession of its property prior to the petition date). These sections are not applicable in a Chapter 9 case. Accordingly, a Chapter 9 debtor cannot obtain greater rights than it had as of the petition date.

The Supreme Court, in *Whiting Pools*, held that the property of the debtor seized by the IRS pre-petition was estate property by reason of the turnover provisions of Section 542. *Id*. at 205 ("§ 541(a)(1) is intended to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code"). In this regard the Court stated that "542(a) grants to the estate a possessory interest in certain property of the debtor that <u>was not held by the debtor</u> at the commencement of reorganization proceedings." *Id*. at 207 (emphasis added). The Court went on to explain that

> if this were not the effect, § 542(a) would be largely superfluous in light of § 541(a)(1). Interests in the seized property that could have been exercised by the debtor—in this case, the rights to notice and the surplus from a tax sale, see n. 4, supra—are already part of the estate by virtue of § 541(a)(1). No coercive power is needed for this inclusion. The fact that § 542(a) grants the trustee greater rights than those held by the debtor prior to the filing of the petition is consistent with other provisions of the Bankruptcy Code that address the scope of the estate.

Id. at n. 15. Thus, the court reasoned that, but for the turnover provisions, the debtor's estate would not include property interests lost by the Debtor pre-petition. *Id*. at 207. Similarly, in the present case, while no estate comes into existence in Chapter 9, the Debtor nevertheless may only have the "greater rights" of possession and control of the System if the Bankruptcy Code gives the Debtor those rights. Because the turnover provisions of Section 543 are not applicable in this Chapter 9 case, the Debtor only has the rights that it had pre-petition.

In this case, the Debtor entered bankruptcy with a set of rights in the System as defined by the Receiver Order – rights that do not include possession, control or rate-making authority. Prior to the Petition Date, the State Court defined the Debtor's rights in the System with the

Receiver Order. The State Court took jurisdiction over the *res* of the System and appointed the Receiver to maintain exclusive possession and control of the System with the sole authority to fix and charge rates and charges for the System's services. Receiver Order at 8; *see also Ex Parte Davis*, 162 So. 306, 308 (Ala. 1935) (discussing the court's jurisdiction in receivership). Under *Whiting Pools*, the Debtor cannot, by operation of the automatic stay, obtain a greater interest in the System than it otherwise held pre-petition. Only the inapplicable turnover provisions of Section 543 would grant such an expanded right because the Debtor's rights to possession are fixed as of the Petition Date. Sections 362 and 922 only stay the Receiver from obtaining any greater rights to the System than it currently possesses.

b. <u>The Receiver's continued control and possession of the System does not violate the automatic stay</u>

Because the Debtor's property rights in the System do not include possession or control of the System, the Receiver's possession and control of the System is not a violation of the automatic stay. Whether an action violates the automatic stay is dependent upon what interest in the property, if any, the Debtor holds. *In re Foskey*, 417 B.R. 836 (Bankr. D.C. 2009) (holding that recording tax sale deed did not violate stay when debtor's rights in the property were subject to the pre-petition tax sale).

In *Foskey* the court addressed the issue of whether an act violates the automatic stay when a debtor has limited rights in property. There, the debtor owned property prior to filing a bankruptcy petition. *Id*. at 838. The District of Columbia sold the property pre-petition at a tax sale. *Id*. In accordance with applicable law, the tax sale purchaser sued the debtor to foreclose the right of redemption and the court granted the purchaser's motion for entry of default judgment and entered a judgment extinguishing the debtor's right to redemption. *Id*. Thereafter the debtor commenced a bankruptcy case. *Id*. Postpetition, the tax sale purchaser paid the taxes to the District of Columbia and obtained title to the property. The purchaser then recorded the tax sale deed. *Id.*

The Debtor asserted that the pospetition acts of paying the taxes and recording the deed violated the automatic stay. *Id.* The court, however, held that there was no stay violation. *Id.* at 841. The court found that the debtor's rights in the property were limited to a specific set of rights as of the petition date. In this regard the court found that

> a judgment had already issued adjudicating that the debtor's right of redemption no longer existed. Foskey continued to hold legal title and enjoy use of the property despite Plus Properties' tendering payment . . . Foskey's rights were limited to a legal title (and the use of the property during the period he held legal title) that was subject to divestment upon Plus Properties performing on its purchase contract.

Id. at 840-841. The court therefore found that the debtor's right in the property as of the petition date consisted of an interest subject to the rights of the tax sale purchaser. *Id.* at 841. With regard to the automatic stay, the court held that "the automatic stay only protects that limited bundle of rights." *Id.* The court reasoned that because the tax sale purchaser's actions did not infringe upon the debtor's limited rights in the property, there was no stay violation. *Id.*

In the present case the State Court determined and limited the Debtor's rights in the System over thirteen (13) months prior to the Petition Date and the Debtor did not appeal or challenge that determination and those limitations. Thus, the Debtor's "bundle of rights" constitute legal title to the System, but not the right to possess, control or fix rates for the System. The State Court assigned those rights to the Receiver pre-petition. Because the Debtor's rights do not include possession or control of the System, the Receiver's exercise of possession and control does not impair any of the Debtor's rights as the Debtor's previous full ownership of the System has been limited by the Receiver Order. *Id.* at 843; *In re Hope*, 231

B.R. 403, 412 (Bankr. D.C. 1999) ("to the extent that an interest in property is limited in the hands of the debtor, it is equally limited in the hands of the estate"). The Receiver is not seeking **any** further limitations on the Debtor or its functions, or seeking to assert any greater claim to the Debtor's property. The Receiver is only seeking a determination that the Debtor is bound by the Receiver Order, and that the Receiver has all powers and authorities described therein. This does not constitute a violation of the automatic stay.

2. *The Legislative History of Sections 922(d) and 928 Indicates that Congress Intended to Exempt Special Revenues From the Automatic Stay*

The stay imposed in Sections 362(a) and 922(a) does not stay the Receiver's collection of the System's revenues. Further, the legislative history of Sections 922(d) and 928 make abundantly clear that special revenues were to be exempt from the stay of 922(d):

> To eliminate the confusion and to confirm various state laws and constitutional provisions regarding the rights of bondholders to receive revenues pledged to them in payment of their debt obligations of a municipality, a new section is provided in the Amendment to ensure that **revenue bondholders receive the benefit of their bargain with the municipal issuer and that they will have unimpaired rights to the project revenues pledged to them.**
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> . . .
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> Where pledges of revenues survive under Section 927 [928], **it would be needlessly disruptive to financial markets for the effectuation of the pledge to be frustrated by an automatic stay[.]**

S. Rep. No. 100-506, at 12, 21 (1988) (emphasis added).[3] The Receiver *is* the effectuation of the Debtor's pledge of the System's revenues. The stay therefore does not apply to the System's revenues or to the creditors' exercise of their pre-petition rights in and to those revenues.

[3] The Senate bill numbered current Section 928 as Section 927.

3. The Automatic Stay Does Not Supersede Section 903's or Section 904's State Sovereignty Controls as to the State Court's Exercise of Control over the System through its Duly-Appointed Receiver

It is important to note that even if the Court has jurisdiction and chooses not to abstain on this issue (despite Judge Proctor's previous decision), the Court ultimately has no authority to remove or otherwise alter the Receiver's authority under the Receiver Order, especially since the filing of a bankruptcy does not simply terminate a receivership in a Chapter 9 case. Section 901 of the Bankruptcy Code lists those sections of the Bankruptcy Code that are applicable in a Chapter 9 bankruptcy. Of particular note, Section 901 does not incorporate Bankruptcy Code Section 543, Sections 1104-1108, or Sections 321-325.

Sections 1104-1107 of the Bankruptcy Code provide the power to appoint a trustee to manage the Debtor and delineate the powers and duties of the trustee. Section 324 provides for the power of the Court to remove a trustee under certain conditions (collectively, Sections 1104-1107 and 321-324 are referred to herein as the "Trustee Provisions"). The Trustee Provisions were excluded from Chapter 9 based upon Congress's concern about the constitutionality of provisions that would significantly interfere with state law, the governmental powers of state entities, and state sovereignty. *See* 6 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 901.01 (15th ed. Rev. 2011). Congress, in deciding not to incorporate the turnover provisions of Sections 542 and 543 or the Trustee Provisions specifically chose to leave this area of federal law vacant in Chapter 9.

Therefore, there can be no argument that the federal preemption doctrine is applicable, as there is no applicable federal law on issues related to the Receiver and the Receiver Order. Leaving the Receiver in place does not conflict with the principles of bankruptcy law, particularly because of the special revenues nature of the System's revenues and the overarching federalism issues of Chapter 9. *See, e.g.*, *Butner v. United States*, 440 U.S. 48, 54-56 (1979) (holding that Congress had not occupied the field in bankruptcy law to overturn state property laws). As a result, the Court has no authority to remove the Receiver, a conclusion that is further buttressed by the arguments related to Section 903 and the Tenth Amendment already raised by the Receiver. Motion at 14.

These federalism and comity concerns, coupled with the fact that the State Court entered the Receiver Order pre-petition, distinguishes this case from *Alliance Capital Management v. County of Orange (In re County of Orange)*, 179 B.R. 185 (Bankr. C.D. Cal. 1994), *reversed in part and remanded*, 189 B.R. 499 (C.D. Cal. 1995). That decision involved noteholder indebtedness secured by pledges of *general* fund revenues; the creditors wanted to *initiate* a post-petition state court mandamus action to require Orange County to set aside funds to cover their lien post-petition. *Id.* at 189. The movants argued that Section 903 "dictates that the state court is the appropriate forum for resolution of the issues relating to the County's compliance with its contractual obligations." *Id.* at 191. The bankruptcy court found against the movants, citing concerns that their argument would essentially eviscerate Section 362.[4] *Id.* By contrast, here, the Receiver was *already* appointed pre-petition (over a year prior to the Petition Date), meaning that the Debtor's rights to possession of the System have already been determined by valid State Court action. The Receiver is not arguing that Section 903 should *always* allow creditors to seek the state court forum to adjudicate their rights; instead, the Receiver posits that Section 903 limits the automatic stay where a state court – an instrumentality of the state – has *already* acted to divest a Chapter 9 debtor of property and is exercising control over it through its duly-

[4] The district court partially reversed the bankruptcy court's decision that the movants did not have a statutory lien and, therefore, did not have a continuing post-petition lien according to Section 552; the court then remanded to the bankruptcy court to determine adequate protection. *In re County of Orange*, 189 B.R. 499, 502-503 (C.D. Cal. 1995).

appointed receiver. This limited application of Section 903 comports with the law and arguments in the Motion.

Likewise, *New Magma Irrigation & Drainage Dist. v. Bd. of Supervisors of Maricopa County (In re New Magma Irrigation & Drainage Dist.)*, 193 B.R. 528 (Bankr. D. Ariz. 1994) is distinguishable. In that case, the bankruptcy court enjoined certain non-debtor Arizona counties' **post-petition** action to raise property taxes to pay for the debtor irrigation district's debt. *Id.* at 537. In the alternative, the court held that the automatic stay applied to prevent the counties from raising taxes, though the court still specifically recognized that "it is appropriate that some assessment be made because it will, in fact, advance the interests of the Debtor[.]" *Id.* at 535-36. In the case, the bankruptcy court did not consider Sections 903 or 904, or the key Tenth Amendments federalism limitations that underlie all of the provisions of Chapter 9. *New Magma* (i) failed to properly analyze its jurisdiction and authority to enter such an order; (ii) did not discuss the specific Bankruptcy Code protections provided to creditors holding claims secured by special revenues; (iii) based its ruling on a misapplication and overly broad interpretation of Section 105 of the Bankruptcy Code; (iv) relied heavily on inapplicable equitable considerations based on the debtor's purported "ability to reorganize," *id.* at 533; and (v) found that there would be no ability to secure a speedy and efficient remedy in state court. None of these factors apply here, particularly in light of the arguments the Receiver and others have previously made relating to federalism concerns, the special revenue nature of the collateral at issue, and the efficient State Court procedures that have been operating for thirteen months.

The above considerations render the decision inapposite here, but even if they do not, the case is also distinguishable on its facts. The *New Magma* court found that the post-petition action of the counties to raise taxes violated the automatic stay; however, this was at least in part because "[t]he amount of taxes to be levied has historically been determined by the Debtor[.]" *New Magma*, 193 B.R. at 531. Here, however, the State Court has already – pre-petition – removed the authority to fix the System's rates from the Debtor and placed it exclusively in the dominion of the Receiver. The Bankruptcy Court cannot therefore retroactively undo that grant of authority. While a post-petition action to vest this authority in the Receiver might be a stay violation, now that the Receiver already has this exclusive authority, the automatic stay cannot operate to eviscerate it. Furthermore, the court in *New Magma* enjoined an action by third party counties unrelated to the debtor; however, in this case, as explained in the Motion, the Receiver has stepped into the shoes of the Debtor with respect to the System. Thus, an attempt by this Court to dictate who has authority to implement rate increases and what those rate increases should be violates both Sections 903 and 904.

In re Addison Cmty. Hosp. Auth., 175 BR 646, 649 (Bankr. E.D. Mich. 1994) appropriately crystallizes why the Bankruptcy Court cannot remove the Receiver by way of the automatic stay:

> "The United States Supreme Court and the courts of appeals have stated that the jurisdiction of the bankruptcy court in Chapter 9 cases is limited to disapproving or approving and carrying out a proposed plan for debt adjustment." HR Rep. No. 595, 262-64. During the developmental period of a plan, the court may not interfere with the distribution and delegation of power established by state law.

The Receiver has already been appointed and delegated the authority to fix and charge rates and charges for the System pursuant to state law. If the Receiver had not been appointed and authorized to fix and charge rates and charges for the System pre-petition, the result might be different. However, because the Receiver is already in place, the Court has no authority under the Bankruptcy Code to remove the Receiver, and Section 903 and the Tenth Amendment strongly support a determination by the court to refrain from doing so.

B. Leaving the Receiver in Place Will Not Hinder the Debtor's Ability to Formulate and Confirm a Chapter 9 Plan

It should first be noted that the Receiver has been the principal facilitator in the settlement discussions between the Debtor and the System's creditors. Further, the Receiver Order does not give the Receiver authority to interfere with functions of the County not directly related to the System. Consequently, an argument that the Receiver would interfere with the Debtor's efforts to negotiate a consensual plan with its creditors appears contrary to the history among the parties. Regardless, for the reasons stated below, the Receiver's continued possession and management of the System will not interfere with the Debtor's ability to propose and confirm a plan to adjust its debts.

1. The Debtor Cannot Use the System's Revenues, as Special Revenues, to Fund Other Expenses or Obligations Under its Plan and the Debtor Does Not Need Control of the System to Adjust its "Special Revenue" Debts

Since the System's revenues are special revenues under the Bankruptcy Code, the Debtor cannot use them for any purpose other than to operate the System and pay the System's debts: "In general, [Section 928's] effect is to prevent special revenues that secure an issue of revenue bonds from being diverted to be available for the municipality's general expenses or obligations." 6 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 928.01 (15th ed. Rev. 2011). The characterization of the System's revenues as special revenues, and the policy of Section 928 to restrict their use by the Debtor, would carry over into any plan of adjustment. *See In re Heffernan Memorial Hosp. Dist.*, 202 B.R. 147 (Bankr. C.D. Cal. 1996). The Debtor therefore cannot propose a plan to use the System's revenues to pay for other debts and expenses unrelated to the System (as the Debtor was doing—in violation of the terms of the Indenture and Alabama law—prior to the Receiver's appointment).

Instead, the continuing lien provided by Section 928 prevents the Debtor from taking the creditors' collateral—the pledged special revenues—and using those revenues, even in the context of a Chapter 9 plan, for anything other than (1) payment of the System's operating expenses and (2) payment of the System's debt. Because the Debtor cannot use the System's revenues to pay other expenses and obligations under a plan, the Debtor has no reason to seek removal of the Receiver. *See, e.g.*, *Matter of Plihal*, 97 B.R. 561, 564-65 (Bankr. D. Neb. 1989) (Debtor who argued that he needed land in the possession of state court-appointed receiver could not require turnover of land where debtor had no right to possess pledged rents from the land and thus benefit to debtor's general reorganization of returning land to debtor was speculative). Further, this Court does not have authority to "adjust" the System's revenue stream. Thus, because the Debtor does not need control of the System to propose a plan, leaving the Receiver in place to apply the special revenues of the System is in accordance with the provisions of the Bankruptcy Code applicable to special revenues and does nothing to hinder the Debtor's ability to propose a plan.

2. Removing the Receiver Diminishes the Debtor's Prospects of Confirming a Plan

Further, the removal of the Receiver does not increase—and in fact diminishes—the Debtor's prospects for confirming a plan. First, the Receiver believes the evidence will show after the hearing on its Motion that the Debtor's commissioners are opposed to sewer rate increases—rates for the System have not been increased, even to keep up with inflation, since 2008. However, in order to confirm a plan, the Debtor must raise rates to some extent in order to satisfy the "best interests of creditors" test of Section 943(b)(7). *See Fano v. Newport Heights Irr. Dist.*, 114 F. 2d 563, 565-66 (9th Cir. 1940) (holding that irrigation district's plan was not in the best interest of creditors where plan did not provide for tax increases to pay the district's debts); 5 Hon. William L. Norton, Jr. & William L. Norton, III, *Norton Bankruptcy Law & Practice* § 90:20 (explaining that the legislative history of 943(b)(7) relies on *Newport Heights* in determining that Chapter 9 debtor must use all of the taxing power at its disposal to fulfill the best interests of creditors test). As stated in the Motion, while the Receiver takes no position at this time on the Debtor's eligibility, it should be noted that at least one court has found that the refusal to use assessment and taxing powers supported a finding that the filing was in bad faith. *See In re Sullivan County Regional Refuse Disposal District*, 165 B.R. 60 (Bankr. D. N.H. 1994) ("Congress did not intend that a municipality that made no effort to use its assessment or taxing powers to meet its obligations before filing nevertheless could come into the bankruptcy courts to resolve what is essentially a contractual dispute with one of its creditors."). Because the commissioners were unwilling to make the politically difficult – though objectively necessary – decision to raise sewer rates, the State Court removed that authority from them and appointed the Receiver with the authority to raise rates. Receiver Order at 8. Section 927 makes the indebtedness secured by the System's revenues nonrecourse to the Debtor's general fund. Accordingly, holders of the Debtor's sewer debt must look solely to the System – and the Debtor's good faith attempts to properly fund it – for repayment of their claims. Leaving the Receiver in place, therefore, will ensure that any plan proposed by the Debtor will be in the creditors' best interest.

Additionally, allowing the Receiver to remain in place will make plan prospects more likely by relieving the Debtor's politicians of the burden of running the System and instead leaving the System's management in the hands of an experienced professional. Several bankruptcy courts in Chapter 11 cases that determined not to require receivers to turn over debtors' property have weighed the managerial benefits of a receiver favorably in making their decisions. *See In re LCL Income Properties, L.P. VI*, 177 B.R. 872, 876 (Bankr. S.D. Ohio 1995) ("By leaving matters in the status quo as it has existed for more than two years [through leaving the receiver in place], debtor will have the opportunity to reorganize contemplated by the bankruptcy laws, and at the same time the interests of creditors will be protected."); *In re Uno Broadcasting Corp.*, 167 B.R. 189, 200 (Bankr. D. Ariz. 1994) (receiver should remain in place because of results receiver has obtained in turning around debtor's operations); *In re Poplar Springs Apartments of Atlanta, Ltd.*, 103 B.R. 146, 150 (Bankr. S.D. Ohio 1989) (fact that debtor's general partner was involved in complicated bankruptcy warranted allowing receiver to remain in place). Here, the evidence will indicate that the Receiver has vastly improved the operations of the System and, given time, will improve them even more, with the result that all parties—the Debtor, the creditors, and the System's customers—will benefit from the Receiver's management. By contrast, the Debtor's historical practice has been to leave the System under-funded so that the Debtor will pay as little as possible of the System's debt. This practice will likely continue if the Receiver is removed, with the result that not only will the Debtor not be able to confirm a plan due to the best interest of creditors test and the creditors will have to watch as the System and the revenue stream that secures payment of their warrants erodes, but also, most importantly, the System's customers will see reduced services and decaying infrastructure that will lead once again to the problems that resulted in the Consent Decree.

Allowing the Receiver to remain in place will have no substantially negative effect on the Debtor's plan prospects, and indeed will have no negative effect at all. The Receiver has been the primary facilitator of negotiations between the Debtor and its creditors and has conferred significant operational efficiencies since taking over management. This beneficial role will not change if the Receiver remains in place. Finally, the Debtor has the ability to challenge any perceived issues with the Receiver's operations in the State Court. (It should be noted that since the Receiver's appointment, the Debtor has never done so, with the exception of the Debtor's own violation of the Receiver Order by refusing to turn over signatory authority of the System's accounts to the Receiver.)

3. Removing the Receiver Will Result in a Plan that Cannot Be Confirmed as Inconsistent with State Law

The Debtor cannot confirm a Plan that contravenes state law. 11 U.S.C. § 943(b)(4); *In re Sanitary & Improv. Dist., No. 7*, 98 B.R. 970, 974-75 (Bankr. D. Neb. 1989). The Debtor, however, seeks to remove the Receiver, re-vest in itself the authority to charge sewer rates and then likely do nothing to raise rates and possibly even use the funds from the System to pay other expenses or creditors. Such actions are inconsistent with Alabama law and do not support an argument to remove the Receiver. *See* Ala. Code § 11-28-3 ("To the extent necessary and sufficient for making the payments secured by any pledge of pledged funds made pursuant to the provisions of this chapter, **such pledged funds shall constitute a trust fund or funds which shall be impressed with a lien in favor of the holders of the warrants** to the payment of which such pledged funds are pledged.") (emphasis added); Ala. Code § 11-28-6 (Warrants issued "shall be deemed to constitute an audit and allowance by such county commission of a claim, **in the aggregate amount of such warrants and the interest thereon**, against such county **and against any pledged funds pledged for the payment of the principal of and interest on such warrants** pursuant to the provisions of this chapter.") (emphasis added); *Bankhead v. Town of Sulligent*, 155 So. 869 (Ala. 1934) (providing that appointment of a receiver ensures that statutory lien is not "a meaningless expression"). These statutes operate to create a statutory lien, not just a security interest, in the System's revenues. *See In re County of Orange*, 189 B.R. 499, 502-503 (C.D. Cal. 1995). Furthermore, as *Bankhead* recognizes, the Receiver is the only effective method of enforcement of that statutory lien under Alabama law. *See also* 5 Hon. William L. Norton, Jr. & William L. Norton, III, *Norton Bankruptcy Law & Practice* § 90:11 (describing how mandamus is not an effective remedy for bondholders). The Debtor therefore cannot modify these statutory interests in its plan without the plan conflicting with Alabama law; thus, any attempt to argue that the Receiver interferes with the Debtor's ability to propose a plan is inapposite—the Debtor could not confirm a plan that removed the Receiver anyway.

Thus, leaving the Receiver in place should not in any way interfere with the Debtor's ability to propose or confirm a Chapter 9 plan. If anything, the Receiver would be able to assist the adjustment process by continuing to effectively and professionally manage the System, to act as a facilitator of negotiations, and to ensure that the tough decisions with respect to rates are made so that the best interests of creditors are met.

C. The Debtor is Precluded from Arguing (i) that the State Court's Appointment of the Receiver With Rate-Making Authority Violated the Alabama Constitution and (ii) that the Bankruptcy Court Should Not Abstain

1. Collateral Estoppel and the Rooker-Feldman Doctrine Preclude the Debtor from Arguing that the State Court Violated Alabama Constitution Amendment 73 in Appointing the Receiver or Granting the Receiver Rate-Making Authority

In its Memorandum in Support of Eligibility [Docket No. 10]), the Debtor appears to argue that the State Court violated Alabama Constitution Amendment 73 by appointing the Receiver with exclusive and irrevocable rate-making authority. However, the Debtor raised this issue in the State Court, the State Court necessarily held that this appointment was not unconstitutional, and the Debtor did not appeal. Thus, the Debtor is now estopped from collaterally attacking the Receiver Order in this Court.

Federal courts apply the law of the state that issued the judgment when deciding whether collateral estoppel applies to give that judgment preclusive effect. *Agripost, Inc. v. Miami-Dade County, ex rel. Manager*, 195 F.3d 1225, 1229 n.7 (11th Cir. 1999). Under Alabama law, collateral estoppel applies where “1) [the] issue [is] identical to one involved in previous suit; 2) [the] issue [was] actually litigated in prior action; and 3) resolution of the issue was necessary to the prior judgment.” *Carlisle v. Phenix City Bd. of Educ.*, 849 F. 2d 1376, 1379 (11th Cir. 1988) (internal quotations omitted) (quoting *Wheeler v. First Ala. Bank of Birmingham*, 364 So. 2d 1190, 1199 (Ala. 1978)). The concepts of collateral estoppel apply in bankruptcy courts. *Grogan v. Garner*, 498 U.S. 279, 284 n.11 (1991). Collateral estoppel also applies to constitutional issues. *See Cotton States Mut. Ins. Co. v. Anderson*, 749 F. 2d 663, 666 (11th Cir. 1984); *Ex parte Smith*, 683 So. 2d 431, 434 (Ala. 1996).

In its Answer filed in the State Court case (attached hereto as **Exhibit A**), the Debtor asserted as its Eighth Defense that “[s]ome or all of the relief [the Indenture Trustee] seeks would violate the Alabama Constitution.” Exhibit A, at p. 30. Likewise, in its Opposition to the Indenture Trustee’s Motion for Partial Summary Judgment (attached hereto as **Exhibit B**), the Debtor argued that “[Alabama courts] may not set rates directly or indirectly. . . . And Judge Proctor has already found (sensibly) that a court-appointed receiver setting rates is no different than the Court itself setting rates.” Exhibit B, at p. 15. The State Court, however, nevertheless granted the Indenture Trustee's summary judgment motion, entered the Receiver Order, appointed the Receiver, and gave the Receiver exclusive, irrevocable rate-making authority. In making its decision, the State Court must have necessarily rejected the Debtor’s arguments that appointing the Receiver with exclusive rate-making authority violated the Alabama Constitution. Furthermore, the time to appeal the Receiver Order has run, *see* Ala. R. App. P. 4(a)(1), as has the time to alter, amend or vacate the Receiver Order, *see* Ala R. Civ. P. 59(e). Thus, the Debtor has already litigated the issue of the rate-making authority of the Receiver in the State Court to a conclusion and lost. Likewise, the Rooker-Feldman doctrine, as discussed in the Motion, would also bar this kind of appeal to the Bankruptcy Court to reexamine the Receiver Order. The Debtor cannot now have the Bankruptcy Court review that final decision.

Moreover, any argument the Debtor makes that the Receiver *might*, in the future, set unreasonable rates in violation of Amendment 73 is unavailing. The Receiver Order by its terms requires the Receiver to set reasonable rates, and nothing prevents the Debtor from challenging the *reasonableness* of the rates in State Court once they are implemented, even if the Debtor is now precluded from challenging the actual Receiver Order.

2. Collateral Estoppel Precludes the Debtor from Arguing that the Bankruptcy Court Should Not Abstain

The Debtor is also estopped from asserting that the Bankruptcy Court should not abstain from interfering with the Receiver Order. In cases decided in federal courts,

> Collateral estoppel bars relitigation of an issue previously decided if the party against whom the prior decision is asserted had 'a full and fair opportunity' to litigate that issue in an earlier case. The party seeking to invoke collateral estoppel must establish that (1) the issue in the pending case is identical to that decided in a prior proceeding; (2) the issue was necessarily decided in the prior proceeding; (3) the party to be estopped was a party or was adequately represented by a party in the prior proceeding; and (4) the precluded issue was actually litigated in the prior proceeding.

United States v. Weiss, 467 F. 3d 1300, 1308 (11th Cir. 2006) (internal citations and quotations omitted).

The Debtor should be estopped from arguing that this Court should not abstain from the issue of whether the Receiver should remain in place. In its Response Brief in Opposition to the Indenture Trustee's Emergency Motion for Appointment of a Receiver in the previous Federal action, attached hereto as **Exhibit C**, the Debtor argued vigorously for abstention as a result of "several questions of Alabama constitutional law that determine how Jefferson County's vested authority over its sewer system relates to the sovereign prerogatives of the State." Exhibit C, at

p. 18. The Debtor also argued the existence of "questions of state law that are unsettled and that implicate the fundamental sovereign interests of Alabama – and in particular, the State's sovereign constitutional interest in assigning powers and duties to Jefferson County." Exhibit C, at pp. 18-19. The Debtor seemed extremely worried about a federal court's interference in issues of fundamental state power and authority and was able to convince Judge Proctor to abstain based on those federalism issues. *See* Memorandum Opinion, Exhibit E to Indenture Trustee's Motion [Docket No. 55], at pp. 40-53. Yet now the Debtor wants this Court to revisit those issues and overturn the Receiver Order.

The Court should not entertain such arguments. The Debtor has already litigated the issue of whether a federal court should become involved in the receivership of the System and was able to convince the federal district court in this jurisdiction to rule in its favor and abstain. Two years later, the Debtor now argues that a federal court – the Bankruptcy Court – should involve itself in intricate state law related to rate-making and receivership issues. The Debtor cannot now come into Bankruptcy Court – another federal court that was referred this bankruptcy case by that very same district court – and claim that this Court should not abstain. Thus, even if all of the arguments in the Motion and in this brief do not convince this Court not to disturb the Receiver Order, the Debtor's very arguments, which the Debtor is collaterally estopped from repudiating at this point, should convince this Court to determine that the Receiver should remain in place. Finally, even if the Court determines that the Debtor should not be estopped from arguing that the Court should not abstain from attempts to remove the Receiver or interfere with the Receiver's rate-making authority, the decision of the U.S. District Court for the Northern District of Alabama in a prior federal case involving the Debtor and the

Indenture Trustee should at the very least have strong persuasive effect on this Court in favor of abstention.

III. Conclusion

For the foregoing reasons, and for the reasons stated in the Motion, the Indenture Trustee's Motion, and in the Supporting Statements, the Receiver respectfully requests that the Court grant the Receiver's Motion.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the above and foregoing paper has been served upon the parties in the attached service list by e-mail, or by placing a copy of same in the U.S. Mail, first-class postage prepaid and properly addressed to such party on November 16, 2011.

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